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RUEHRC/DEPT OF AGRICULTURE WASHDC  
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SUBJECT: AZERBAIJAN: AMBASSADOR DISCUSSES UPCOMING CAS  
DRAFT WITH WORLD BANK MISSION

REF: STATE 5622

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HANDLE ACCORDINGLY.

1. (SBU) SUMMARY: According to the World Bank mission, the Country Assistance Strategy (CAS) for Azerbaijan will focus upon the goals and projects outlined in the April 2005 Poverty Reduction Support Credit agreement between the GOAJ and the World Bank. According to the Bank mission, the total lending envelope for all investment projects in Azerbaijan will total approximately USD 1 billion, of which a yet undetermined amount of funding would come from the International Development Association for health, education, and social projects. The draft CAS envisions 100 percent of the lending to Azerbaijan be for "investment projects." The mission broadly outlined its goals which includes focusing on improving government accountability, reforms in the utility and transportation sectors, and agricultural and rural development. END SUMMARY.

2. (SBU) On February 3 Ambassador Harnish met with World Bank lead economist for the South Caucasus, Christian Petersen, and other members of the visiting World Bank mission to discuss the draft Azerbaijan Country Assistance Strategy (CAS) for 2005-2009. The World Bank mission emphasized its desire to cooperate on the planning of the CAS with the U.S. mission, and especially USAID, to ensure that Bank and USAID projects complement one another. USAID Country Coordinator told the team that USAID plans to liaise closely with the Bank team during its visit and would provide additional details on proposed USAID projects and the focus areas of U.S. assistance. The team noted that the Azerbaijan CAS will be presented to the World Bank Board in May 2006.

General Outline of Draft CAS  
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3. (SBU) Petersen told Ambassador Harnish that the CAS draft will focus on supporting the current reforms outlined in the April 2005 Poverty Reduction Support Credit agreement between the World Bank and Azerbaijan. Overall, U.S. assistance to Azerbaijan complements most of the policy areas within the Policy Framework Matrix of the Poverty Reduction Support Credit plan. Petersen told the Ambassador that the CAS's total lending envelope for all investment projects would total approximately USD 1 billion. Of the USD 1 billion, a yet undetermined amount of funding would come from the International Development Association for health, education, and social projects. Ambassador Harnish emphasized the need to maintain IDA funding, particularly for health projects in

Azerbaijan, past 2007 when it would end. According to Petersen, the draft CAS envisions 100 percent of the lending to Azerbaijan will be for "investment projects."

#### Corporate Governance and Accounting

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¶4. (SBU) Petersen outlined to Ambassador Harnish the Bank's interest in working with the Ministry of Finance to improve Azerbaijan's corporate governance and accounting. This project would work to implement international financial reporting standards for larger commercial entities, particularly the large state-owned entities. It also will focus on implementing public sector accounting standards and will create endowments or faculties at local universities to train new accountants. The project would also support internal controls within the GOAJ and strengthen the Chamber of Accounts (the government auditor).

¶5. (SBU) The U.S. is working in partnership with the World Bank to develop and install a Treasury Information System at the Ministry of Finance. The U.S. is funding the development of the TIMS software and the World Bank is handling the procurement of the hardware. The U.S. and the World Bank also maintain close coordination to improve public sector accounting, macroeconomic modeling capacity and economic policy coordination of the GOAJ. In other areas the U.S. is working in parallel with the World Bank such as in the area of protection against unfair competition. The World Bank assisted in the development of a new anti-monopoly law and the U.S. is providing training. Similarly, the U.S. is providing support to the National Bank of Azerbaijan to improve its supervision and monetary functions and develop

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its legal and regulatory framework as outlined in World Bank and IMF recommendations.

¶6. (SBU) The World Bank team briefed on its judicial reform project, which was shaped with active engagement by Embassy officers, scheduled for June 2006. The World Bank had originally planned to focus on other areas of judicial reform but revised its approach after discussing GOAJ needs with Embassy officers. The Project envisions creating greater citizen access to the judicial branch through the development of a legal resource center and attorney client consultation rooms. The project also develops greater institutional transparency with the creation of a case assignment and management system and a system to begin recording and transcribing judicial proceedings. The project would also build capacity at the Ministry of Justice by modernizing judicial buildings and assisting with training of new and existing judges.

#### State Program on Communications and Information Technology

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¶7. (SBU) The Bank's approach in the communication and IT field includes a project to promote e-government, expand Internet access throughout Azerbaijan's schools and universities. In addition, the project would increase Internet and information technology knowledge among youth.

#### Tariff Council - Moving Along

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¶8. (SBU) Regarding the Azerbaijani Tariff Council, Petersen noted that the GOAJ's efforts to strengthen its mandate as positive, despite disappointment that the GOAJ had decided not to move forward with its commitment to implement an independent regulator. Citing as an example of the council's increased independence, Petersen noted that it had decided to double the price of diesel from 900 manats a liter (19 cents) to 1,800 manats (39 cents) in early January 2006. Petersen noted that the council is creating a 20-person secretariat to assist with the council's work. The Ministry

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of Economic Development has told the World Bank that it plans to develop the Tariff Council secretariat eventually into a permanent regulatory body. The World Bank team lamented the lack of additional funding to PA Consulting,s contract to build an energy regulator, citing PA,s work as extremely useful.

#### Transportation Sector

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¶9. (SBU) The World Bank envisions focusing upon improving Azerbaijan,s transportation infrastructure, including projects to construct roads and upgrade the railroad system.

#### Agriculture and Rural Development Sector

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¶10. (SBU) Petersen told Ambassador Harnish that the Bank plans to continue with the Agriculture Credit Development Program, improve Azerbaijan,s veterinary services, bolster its capacity to respond to crises, such as avian influenza, continue to fund farm and cooperative financing and fund rural development irrigation projects. Petersen said that the GOAJ had decided to support the development of a unified land registry after the GOAJ,s decision to combine the two national land registries into a single registry.

¶11. (SBU) U.S. assistance is active is the commercial agriculture sector with projects focusing on improving the business practices of processors and exporters and bringing farmers more into the marketing chain. An area where the World Bank could support U.S. assistance projects is with agricultural sector policy reform, focusing upon creating a more market-oriented sector and financing improvements to the physical infrastructure (road construction, etc.).

#### GOAJ,s Public Equity Fund

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¶12. (SBU) The World Bank team discussed the use of investment and loan funds by the GOAJ which are distorting certain sectors of the economy. In 2006, the GOAJ plans to spend USD 80 million in equity investments to help enterprises get

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established and grow. The GOAJ is also funding an Entrepreneurship Fund with USD 100 million for subsidized lending. The Bank questions the manner in which the GOAJ will select projects and set interest rates. Bank economists opined that the GOAJ has recognized the investment weakness of the banking sector and is stepping in to provide financing in rural areas to improve rural industry. The Bank team noted that the business climate in Azerbaijan has worsened since 2002 and the team did not support the GOAJ investment and loan funds. The Bank also is hoping to provide some professional management oversight of the funds through IFC.

#### Utility Sector

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¶13. (SBU) Petersen told the Ambassador that based upon previous difficulty working with the GOAJ on water projects, future water projects may not be included in the CAS. Petersen cited the USD 50 million water project which the GOAJ canceled days prior to beginning final negotiations. The GOAJ informed the Bank that it no longer needed the money and would fund the project from its budget. Petersen indicated that the Bank would like to replicate the Asian Development Bank,s "City,s Development Strategy" program to provide urban planning assistance to develop specific Azerbaijani cities.

¶14. (SBU) On the energy side, Petersen said that the Bank has discussed projects with the Ministry of Energy focusing on

improving storage facilities, treating natural gas (NOTE: 60 percent of Azerbaijan,s gas goes untreated into its pipelines), and rehabilitating pipelines (including gas leakage prevention). The Bank said it would use "carbon lending" with the energy projects to raise the GOAJ,s awareness of environmental costs and externalities to ensure environmentally sound projects.

#### Health and Human Development

¶15. (SBU) Petersen said that hopefully the Bank,s health project will go to the Board by June 2006 (and thus ensure IDA financing). In addition, the Bank looks to focus upon tertiary educational issues. The U.S. is currently funding a Primary Health Care (PHC) Strengthening project in Azerbaijan which was designed to collaborate with a World Bank funded health project that deals with primary health care. Although the GOAJ has not yet approved the World Bank loan terms, the new Minister of Health is actively engaged in designing the World Bank health project with technical assistance from the USAID/PHC Strengthening project.

¶16. (SBU) USAID/PHC Strengthening project will work in the same pilot regions as the World Bank health project. Loan funds will be used to procure medical equipment and for clinic renovations. In these pilot sites, the USAID/PHC Strengthening project will provide technical assistance on resource management, implementation of PHC services, quality of care, and health promotion and communication. At the policy level the USAID/PHC Strengthening project is providing technical assistance to the MOH as they work to determine the scope of PHC services and the structure of PHC system. These goals are shared by the World Bank health team. Furthermore, the USAID/PHC Strengthening project will participate with World Bank Health Appraisal Team expected in March 2006.

HARNISH